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BEFORE THE ARIZONA CORPORATION
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COMMISSIONERS

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MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION
OF ARIZONA PUBLIC SERVICE
COMPANY FOR AN ORDER OR
ORDERS AUTHORIZING IT TO ISSUE,
INCUR, AND AMEND EVIDENCES OF
LONG-TERM INDEBTEDNESS AND
SHORT-TERM INDEBTEDNESS, TO
EXECUTE NEW SECURITY
INSTRUMENTS, TO SECURE ANY
SUCH INDEBTEDNESS, TO REPAY
AMOUNTS PAID UNDER ANY
PINNACLE WEST CAPITAL
CORPORATION GUARANTEE OF
ARIZONA PUBLIC SERVICE COMPANY
INDEBTEDNESS AND FOR
DECLARATORY ORDER

DOCKET NO. E-01345A-06-0779

IN THE MATTER OF THE APPLICATION
OF PINNACLE WEST CAPITAL
CORPORATION FOR AN ORDER OR
ORDERS AUTHORIZING IT TO
GUARANTEE THE INDEBTEDNESS OF
ARIZONA PUBLIC SERVICE COMPANY

Arizona Corporation Commission
DOCKETED

MAY 29 2007

DOCKETED BY

nr

COMMENTS OF ARIZONA PUBLIC SERVICE COMPANY
ON STAFF REPORT

I. INTRODUCTION

Arizona Public Service Company ("APS" or the "Company") hereby submits the following comments on the Staff Report (the "Staff Report") filed in the above docket on May 18, 2007. The Staff Report recognizes the continued benefits to APS and its customers of the financial flexibility that previous Arizona Corporation Commission

1 (“Commission”) financing orders have provided since 1984. The Company supports the
2 Staff Report’s fundamental recommendations but must suggest specific modifications and
3 clarifications, as discussed in greater detail below. In doing so, the Company seeks to
4 insure that the flexibility and other benefits provided by a new financing order are not lost
5 because APS or APS’ future lenders and investors are unable to definitively confirm that
6 the Commission has clearly authorized a particular debt issuance or how any limitation on
7 that authority is to be interpreted.
8

9
10 Pinnacle West Capital Corporation (“Pinnacle West”) joins in this filing for the
11 purpose of the subject matter of Paragraph 14 below. Paragraph 14 addresses Pinnacle
12 West’s request to guarantee the debt of APS, which likely constitutes a “reorganization”
13 of Pinnacle West under A.A.C. R14-2-803.
14

15 Capitalized terms used in this filing that are not otherwise specifically
16 defined in these comments have the meanings ascribed to those terms in the APS/Pinnacle
17 West Verified Application in this Docket, dated December 15, 2006 (the “Application”).
18

19 **II. CONDITIONS TO ISSUANCES OF DEBT**

20 1. The Staff Report recommends Commission approval of the Company’s requested
21 increase in its Continuing Long-Term Debt limit to \$4.2 billion if, “subsequent to any debt
22 issuance, APS can satisfy the following conditions: (1) common equity must represent at
23 least 40 percent of total [capital] (common equity, preferred stock, long-term debt and
24 short-term debt) and (2) the debt service coverage ratio (“DSC”) is equal to or greater than
25 1.0.” (Staff Report at 5.)
26
27
28

2. As explained in greater detail below, the Company agrees with the Staff's recommendation regarding a common equity and debt service coverage test, subject to specific clarifications and modifications. As a preliminary matter, however, the Company requests that instead of the tests applying to "any debt issuance," the tests should apply only when the Company is issuing long-term debt in recognition of the fact that the Company normally issues short-term debt in the form of commercial paper on a daily basis. Computing these tests on a daily basis would be impractical and unnecessarily burdensome. The Company agrees that a short-term debt component would be included in the coverage calculations at the time the Company issues long-term debt.

Calculation of Common Equity Test

3. Commission Decision No. 65796 (April 4, 2003), which prohibits APS from paying dividends unless it maintains a minimum common equity ratio of 40%, calculates the common equity percentage as follows: "APS' common equity [shall] be divided by the sum of such common equity and APS long-term debt (including current maturities of such debt)." (Commission Decision No. 65796 at 25.) Although there is little difference between the two calculations under normal circumstances, for the sake of consistency of application, the calculation methodology in Commission Decision No. 65796 should be adopted for purposes of this limitation. APS also proposes that the calculation be made as of the end of APS' most recent fiscal quarter, adjusted to give effect to the issuance of any new indebtedness. Calculations of APS' common equity percentages under each approach at March 31, 2007, APS' most recent fiscal quarter, are attached to this filing as Exhibit A.

Debt Service Coverage Ratio

4. The Staff Report recommends that the DSC be “calculated as operating income plus depreciation and amortization and income tax divided by interest and [principal] on short-term and long-term debt less short-term debt and interest related to purchased power and natural gas and using the most recent audited financial statements adjusted to reflect changes to outstanding debt.” (Staff Report at 5, n. 1.)

5. APS acknowledges the Staff’s request “for financial parameters to place conditions on the borrowings to prevent APS from taking on an excessive amount of debt” (Staff Report at 4). APS believes that the common equity ratio referenced in Paragraph 2, combined with a debt service coverage test, could effectively address this request. As proposed by the Staff, however, the DSC would require numerous modifications and clarifications so that the DSC calculation methodology is clear under the various circumstances when the DSC would need to be calculated. Absent these modifications and clarifications, neither APS nor APS’ future lenders and investors will have the required certainty that the Commission has clearly authorized APS’ incurrence of a specific debt obligation. As a result, APS proposes a “Modified DSC,” as discussed below.

(a) The inclusion of long-term and short-term principal debt repayments in the “denominator” of the DSC calculation would result in (i) a debt service coverage calculation inconsistent with APS’ historical financing program and the coverage tests applied to APS by its lenders and the rating agencies and (ii) numerous interpretive issues, which are addressed below in clause (c) of this Paragraph 5.

1 (b) Historically, APS' debt has not been amortized and repaid over the life of
2 the debt, as is the case with the debt of many other public service corporations regulated
3 by the Commission. With amortizing debt, much like a typical home mortgage loan, a
4 portion of each payment is used to pay down principal. On the other hand, APS and other
5 large investor-owned utilities generally repay in full their outstanding debt obligations at
6 maturity, usually with the proceeds of another debt issuance. During 2005, for example,
7 APS repaid approximately \$568 million of maturing long-term debt and issued
8 approximately \$412 million of new long-term debt. When APS repays its long-term debt,
9 the DSC will be artificially reduced and will not provide an accurate measure of APS'
10 financial health given that APS generally issues new debt to replace the "bullet maturity"
11 debt. Similarly, maturing short-term debt is typically rolled over with new issuances of
12 short-term debt. APS proposes a modified DSC (the "Modified DSC") that would exclude
13 principal debt repayments. The coverage test that would be reflected in the Modified DSC
14 is widely accepted in the financial community and is the only type of coverage test found
15 in APS' credit agreements. In addition, the rating agencies evaluate APS using this type
16 of coverage test. Calculations of the DSC (using the Company's best interpretation of that
17 test) and the proposed Modified DSC at December 31, 2006 are attached to this filing as
18 Exhibit B.¹

23 (c) If the Commission determines that the DSC, rather than the Modified DSC,
24 is an appropriate financial test, APS requests that the Commission address the issues
25

26
27 ¹ Under the DSC, the Staff also recommended the exclusion of "short-term debt and interest related to purchased
28 power and natural gas" from the denominator of the DSC calculation. Under the Modified DSC, APS proposes that
this exclusion would no longer be necessary.

1 related to the DSC that are set forth on Exhibit C, which APS believes are the significant,
2 but perhaps not the only, issues that must be addressed to resolve existing ambiguities.

3 4 **III. OTHER STAFF REPORT RECOMMENDATIONS**

5 **Short-Term Debt Limit**

6 6. The Staff Report recommends that the Commission authorize APS to incur short-
7 term debt of up to 7% of APS' capitalization plus up to \$500 million of additional short-
8 term borrowings for purchases of natural gas and power. (Staff Report at 5.) APS agrees
9 with this recommendation but requests two modifications:
10

11 (a) First, the Staff Report recommends that, as a condition of APS incurring the
12 additional \$500 million of short-term debt, "APS has a Commission authorized adjustor
13 mechanism for recovery of these costs" (Staff Report at 6). For purposes of clarity, APS
14 suggests that the phrase "for recovery of these costs" be changed to "for recovery of
15 natural gas or power purchases."
16

17 (b) Second, if the "Commission authorized mechanism" is terminated, APS
18 requests that the Commission's authorization for the related short-term debt would
19 terminate 12 months thereafter. This would provide APS with sufficient time to prudently
20 address its short-term debt balances.
21

22 **Declaratory Order Regarding Traditional Indebtedness for Borrowed Money**

23 7. The Staff Report recommends that the Commission deny APS' request for a
24 declaratory order confirming that only traditional indebtedness for borrowed money
25 requires prior Commission authorization. (Staff Report at 5.) If the Commission accepts
26 the Staff's recommendation in this regard, APS suggests that the Commission adopt the
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28

1 following additional provisions to avoid unintended and patently unfair consequences
2 should APS exceed its authorized debt limits solely as a result of future changes in United
3 States generally accepted accounting principles (“GAAP”) or future changes in the
4 interpretation of GAAP (collectively, “GAAP Changes”):
5

6 (a) Any contract or other legally-binding arrangement to which APS was a
7 party as of the date of the Commission’s order in this matter (the “Existing Obligations”),
8 will not be considered indebtedness for purposes of the order (including the order’s debt
9 limitations, common equity test, and debt service coverage test) if the Existing Obligation
10 was not considered indebtedness under GAAP as of such date.
11

12 (b) If a GAAP Change subsequently occurs that results in an Existing
13 Obligation being reclassified as indebtedness, APS will notify the Commission of such
14 GAAP Change within 30 days after APS files its Quarterly Report on Form 10-Q or its
15 Annual Report on Form 10-K with the Securities and Exchange Commission following
16 the end of the fiscal quarter in which such GAAP Change occurs (the “Notification
17 Period”).
18

19 (c) If, after the Commission’s issuance of an order in this matter, APS enters
20 into a contract or binding arrangement that is not considered indebtedness under GAAP
21 but subsequently is considered indebtedness because of a GAAP Change, APS’
22 obligations under such contract or arrangement will not be considered indebtedness for
23 purposes of the order (including the order’s debt limitations, common equity test, and debt
24 service coverage test) until further Commission action if, within the Notification Period,
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1 APS files an application with the Commission specifically requesting approval of such
2 reclassified debt obligations.

3 Replacement of Existing Authorizations

4
5 8. The Staff Report recommends that "[the] authorizations to incur short-term and
6 long-term debt obligations provided in this proceeding should replace all existing
7 authorizations, and all existing authorizations should terminate upon the effective date of
8 the authorizations provided in this proceeding." (Staff Report at 6.)

9
10 9. APS agrees with Staff's recommendations in this regard, which APS believes were
11 focused on Decision Nos. 55017 (May 6, 1986) and 54230 (November 8, 1984) (identified
12 in the Application as the 1986 Order and the 1984 Order, respectively), with the following
13 exceptions. Commission Decision Nos. 55120 (July 24, 1986) and 55320 (December 5,
14 1986) (the "Sale-Leaseback Authorizations") are separate and independent financing
15 authorizations that must remain in full force and effect. Each of these Decisions, copies
16 of which are attached as Exhibits D and E, respectively, relates to the Company's sale and
17 leaseback of a portion of Unit 2 of the Palo Verde Nuclear Generating Station. The Sale-
18 Leaseback Authorizations, pursuant to which APS entered into three separate sale-
19 leaseback transactions in 1986, are also financing authorizations in that they permit APS
20 to:
21
22

23 "issue, assume, guarantee, and incur evidences of indebtedness in order to
24 consummate, and to perform its obligations and exercise its options under,
25 the Lease Transactions (including the issuance or incurrence of evidences of
26 indebtedness in connection with the financing of Capital Improvements as
27 required or permitted by the terms of the Leases, the costs of which will be
28 reflected in an adjustment to lease rentals) including, but not limited to, (i)
the issuance or incurrence of evidences of indebtedness by the Funding
Corporation, secured by the direct obligation of the Company; (ii) the

1 issuance or incurrence of evidences of indebtedness in connection with any
2 letter of credit or financial guaranty securing the Equity Investors for the
3 payment of amounts payable by the Company under the Lease and related
4 documents; (iii) the issuance or incurrence of evidences of indebtedness
5 necessary for any refunding of indebtedness; (iv) the assumption of
6 indebtedness by the Company upon the occurrence of certain events as
7 required by the Leases; (v) the adjustment of rents from time to time as
8 required by the Leases; and (vi) the extension of supplements to the Lease
9 as required or permitted by the Leases.” (Decision No. 55120 at 9-10.)

10 10. It is important to APS and the numerous other parties to the sale-leaseback
11 transactions that the Sale-Leaseback Authorizations remain in full force and effect. The
12 parties entered into those transactions in reliance upon the Sale-Leaseback Authorizations.

13 **Termination of Authorizations Under New Order**

14 11. The Staff Report recommends that “[the] short-term and long-term debt levels
15 authorized in this proceeding terminate on December 31, 2012.” (Staff Report at 6.) In
16 order to alleviate potential concerns about the validity of APS’ indebtedness after
17 December 31, 2012, APS suggests that the Commission order in this proceeding confirm
18 that all short-term and long-term debt legally outstanding at December 31, 2012 remain
19 authorized and valid obligations of APS.

20 12. APS also requests that the December 31, 2012 termination date be extended until
21 the Commission issues a new financing order replacing the then-existing order, provided
22 that (a) APS files an application for a new financing order on or before December 31,
23 2011 and (b) the Commission has not issued an order pursuant to such application on or
24 before December 31, 2012. This will ensure that APS’ ability to access the capital
25 markets is not abruptly terminated, which would prohibit APS from funding its ongoing
26 operations and meeting its obligations as a public service corporation.

Miscellaneous Comments

13. The Staff Report states that “[t]o the extent that the purposes set forth in the application may be considered reasonably chargeable to operating expenses or to income, APS requests that the order or orders from the Commission in this matter authorize such charge or charges and that they be deemed working capital requirements.” (Staff Report at 3.) The Application did not request the Commission to find that purposes reasonably chargeable to operating expenses or to income “be deemed working capital requirements.” In order to comply with A.R.S. Section 40-302(A), the Application stated that “[t]o the extent that the purposes set forth herein may be considered reasonably chargeable to operating expenses or to income, the Company requests that the order or orders of the Commission in this matter authorize such charge or charges.” (Application at 9.) The Company respectfully requests that the Commission’s order in this matter not include language regarding “deemed working capital requirements” because not all the uses to which cash proceeds from the requested financing order would potentially be used can be classified as “working capital.”

14. The Staff Report references a “waiver now in existence (per Decision Nos. 65796 and 55017) of A.A.C. R14-2-803” (Staff Report at 2) in connection with its recommendation that the Commission “[authorize] Pinnacle West to guarantee APS’ debt from time to time in indeterminate amounts” (Staff Report at 7). No such waiver was granted to Pinnacle West in either of the cited Decisions, but Pinnacle West supports the Staff’s recommendation.

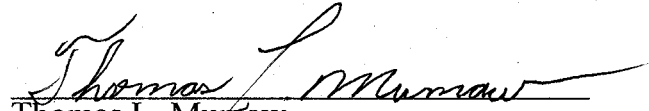
1 15. The Staff Report recommends that, "on each occasion when APS enters into a new
2 long-term debt agreement, APS file with Docket Control a description of the transaction
3 and a demonstration that the rates and terms are consistent with those generally available
4 to comparable entities at the time." (Staff Report at 7.) Recognizing that the Staff Report
5 also recommends that the Commission deny APS' request for a declaratory order
6 confirming that only traditional indebtedness for borrowed money requires Commission
7 approval (Staff Report at 5), APS assumes that the Staff's filing recommendation would
8 cover any transaction classified as long-term debt from a GAAP perspective, regardless of
9 its nature or size. If so, APS believes that such a requirement will result in filings for
10 transactions in which the Commission presumably will have little or no interest and which
11 will require APS time and expense to prepare. For example, every capital lease with a
12 term of 12 months or longer that APS enters into would be subject to the filing
13 requirement, including capital leases for vehicles, equipment, and copy machines. APS
14 requests that such filing requirement be limited to long-term debt agreements involving
15 traditional indebtedness for borrowed money. In addition, APS requests that such filing
16 requirement exclude any long-term debt agreement that has a principal value of less than
17 \$5 million. As is the case with non-traditional indebtedness, APS believes that including
18 immaterial debt agreements among the required filings will result in filings for
19 transactions in which the Commission presumably will have little or no interest on an
20 individual basis and which will require APS time and expense to prepare.

21 16. The Staff Report "further recommends authorization of the other financing requests
22 made by APS in this application except as otherwise specified [in the Staff Report]."
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1 (Staff Report, Executive Summary.) Consistent with the Staff's position in this regard, as
2 well as the Company's suggested modifications and clarifications above, the Company
3 has attached as Exhibit F to this filing proposed language for a Commission Order in this
4 matter, including alternative language in those cases in which the Company has suggested
5 different approaches to the resolution of a specific issue.
6

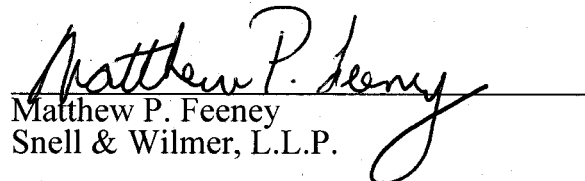
7
8 RESPECTFULLY SUBMITTED this 29th day of May, 2007.

9 By:


Thomas L. Mumaw

10
11 ATTORNEY FOR ARIZONA PUBLIC
12 SERVICE COMPANY

13 By:


Matthew P. Feeney
Snell & Wilmer, L.L.P.

14
15 ATTORNEY FOR PINNACLE WEST
16 CAPITAL CORPORATION
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1 ORIGINAL and 13 copies filed with
2 Docket Control this 29th day of May 2007.

3 COPIES hand-delivered this 29th day of
4 May 2007, to:

5 Mr. Christopher C. Kempley
6 Chief Counsel, Legal Division
7 Arizona Corporation Commission
8 1200 West Washington Street
9 Phoenix, Arizona 85007

10 Mr. Ernest G. Johnson
11 Director, Utilities Division
12 Arizona Corporation Commission
13 1200 West Washington Street
14 Phoenix, Arizona 85007

15 Ms. Lyn Farmer
16 Chief Administrative Law Judge, Hearing Division
17 Arizona Corporation Commission
18 1200 West Washington Street
19 Phoenix, Arizona 85007
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22
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1 EXHIBITS

2 Exhibit A Calculations of Arizona Public Service Company's Common
3 Equity Percentages at March 31, 2007, Using Alternative
Approaches.

4 Exhibit B Calculation of Arizona Public Service Company's DSC and
5 proposed Modified DSC at December 31, 2006.

6 Exhibit C Issues Regarding the DSC Requiring Commission Resolution.

7 Exhibit D Arizona Corporation Commission Order in Decision No. 55120,
dated July 24, 1986.

8 Exhibit E Arizona Corporation Commission Order in Decision No. 55320,
9 dated December 5, 1986.

10 Exhibit F Certain Language for Proposed Order.
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EXHIBIT A

ARIZONA PUBLIC SERVICE COMPANY
Calculation of Common Equity Test
Per ACC Order No. 65796 Dated April 4, 2003
As of March 31, 2007
(\$000)

ARIZONA PUBLIC SERVICE COMPANY
Calculation of Common Equity Test
Per ACC Staff Report in Docket No. E-01345A-06-0779
As of March 31, 2007
(\$000)

Common Equity	\$ 3,202,664 A	Common Equity	\$ 3,202,664 A
Long Term Debt less Current Maturities	2,877,377	Long Term Debt less Current Maturities	2,877,377
Current Maturities of Long Term Debt	1,049	Current Maturities of Long Term Debt*	1,049
--	--	Short Term Debt	--
Total Long Term Debt	\$ 2,878,426	Total Debt	\$ 2,878,426
Total Capitalization	\$ 6,081,090 B	Total Capitalization	\$ 6,081,090 B
Common Equity Ratio	52.7% A/B	Common Equity Ratio	52.7% A/B

* Staff Report does not specifically list Current Maturities of Long Term Debt as being included in this calculation. We assume it's included in Staff's definition of long term debt.

EXHIBIT B

ARIZONA PUBLIC SERVICE COMPANY
Calculation of Debt Service Coverage Ratio ⁽¹⁾
Twelve Months Ended December 31, 2006
(\$000)

Operating Income	\$ 397,942
Depreciation & Amortization	353,057
Income Taxes	144,127
Cash Flow	<u>\$ 895,126 A</u>
Long-Term Principal Repayments	\$ 86,086
Short-Term Principal Repayments	-
Long-Term Interest	149,240
Short-Term Interest	9,529
Less:	
Short-Term Debt for Natural Gas and Purchased Power (PP)	-
Interest on Short-Term Debt for Natural Gas and PP	-
Plus:	
Principal on New Short-Term Debt	-
Interest on New Short-Term Debt	-
Principal on New Long-Term Debt	-
Interest on New Long-Term Debt	-
Total Principal & Interest	<u>\$ 244,855 B</u>

Debt Service Coverage Ratio 3.66 A/B

ARIZONA PUBLIC SERVICE COMPANY
Calculation of Modified Debt Service Coverage Ratio
Twelve Months Ended December 31, 2006
(\$000)

Operating Income	\$ 397,942
Depreciation & Amortization	353,057
Income Taxes	144,127
Cash Flow	<u>\$ 895,126 A</u>
Long-Term Interest	149,240
Short-Term Interest	9,529
Plus:	
Interest on New Short-Term Debt ⁽²⁾	-
Interest on New Long-Term Debt ⁽³⁾	-
Total Interest	<u>\$ 158,769 B</u>

Modified Debt Service Coverage Ratio 5.64 A/B

Notes:

(1) See Exhibit C for list of questions in order to calculate this ratio.

(2) The interest impact of changes to outstanding short-term debt to the date of calculation, calculated as the annualized interest at the actual interest rate on any new short-term debt issued after the 12 month period covered by the applicable audited financial statements and remaining outstanding on the date of calculation.

(3) The interest impact of changes to outstanding long-term debt to the date of calculation, calculated as the annualized interest at the actual interest rate on any new long-term debt issued after the 12 month period covered by the applicable audited financial statements and remaining outstanding on the date of calculation plus the new annualized interest at the expected interest rate on the new long-term debt to be issued or incurred and for which the DSC calculation is being made.

Exhibit C

Issues Regarding the DSC Requiring Commission Resolution

Questions regarding principal on long-term and short-term debt:

1. Are maturities of long-term debt that existed during the prior calendar year to be included, even if the principal on such debt has already been repaid?
2. Does APS assume that the short-term debt balance that exists at the prior year-end is to be repaid, even if those balances may be rolled over?
3. Does APS include maturities of long-term debt that are expected to be paid during the upcoming calendar year?
4. Since new long-term debt is usually issued prior to the maturity date of an existing long-term debt series, does APS net the new long-term debt against the matured/repurchased long-term debt during the upcoming calendar year?
5. If the new long-term debt issuance occurs before the calendar year of the matured/repurchased long-term debt but the use of proceeds in the financing prospectus identifies the purpose as repaying the maturing long-term debt, does APS net the new long-term debt against the maturing long-term debt?
6. Since short-term debt is often incurred prior to the issuance of new long-term debt, does APS assume maturing short-term debt and new long-term debt can be netted against each other?

Questions Regarding "Subsequent Adjustments":

7. The footnote definition of DSC states that the DSC calculation is "adjusted to reflect changes to outstanding debt".

- (a) Does this include long-term and short-term debt?
- (b) Does it include both increases and decreases to debt balances?
- (c) Is it meant to cover both principal and interest?
- (d) If long-term debt does not mature for several years and no principal payments are required until maturity, does that principal payment need to be added?
- (e) If interest is to be added, should it be annualized?
- (f) What rate of interest should be used for short-term debt that has been issued at various points in time?

8. APS must satisfy the DSC "subsequent to any debt issuance."

- (a) Does APS do a pro-forma calculation that would add the principal and annualized interest on the impending debt issuance?
- (b) Please respond to questions 7(a), 7(c), 7(d) and 7(e) in regard to the pro-forma calculation of principal and interest.

Questions regarding the phrase "less short-term debt related to purchased power and natural gas" in the definition of DSC:

9. How should APS calculate the interest offset for short-term debt related to purchased power and natural gas costs?

BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
CHAIRMAN
MARCIA WEEKS
COMMISSIONER
SHARON B. MEGDAL
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF)
ARIZONA PUBLIC SERVICE COMPANY FOR AN)
ORDER OR ORDERS: (1) AUTHORIZING IT TO)
ENTER INTO VARIOUS TRANSACTIONS AND)
AGREEMENTS RELATING TO THE SALE AND)
OPERATING LEASE OF ALL OR A PORTION OF)
THE COMPANY'S UNDIVIDED OWNERSHIP)
INTEREST IN UNIT 2 OF THE PALO VERDE)
NUCLEAR GENERATING STATION AND CERTAIN)
COMMON FACILITIES; (2) AUTHORIZING IT)
TO ISSUE OR INCUR EVIDENCES OF INDEBTED-)
NESS IN CONNECTION THEREWITH; (3) CON-)
FIRMING THAT THE OWNER TRUSTEE AND THE)
EQUITY INVESTORS WILL NOT BE "PUBLIC)
SERVICE CORPORATIONS"; (4) CONFIRMING)
THAT THE LEASES WILL BE "OPERATING)
LEASES" FOR ACCOUNTING PURPOSES; AND,)
(5) DESCRIBING THE RATE-MAKING)
TREATMENT OF THE PROPOSED TRANSACTIONS.)

DOCKET NO. U-1345-86-105

DECISION NO. 55120

Arizona Corporation Commission

DOCKETED

JUL 24 1986

DOCKETED BY

dmk

OPINION AND ORDER

DATE OF HEARING: July 10, 1986

PLACE OF HEARING: Phoenix, Arizona

PRESIDING OFFICER: Thomas L. Mumaw, Chief Hearing Officer

IN ATTENDANCE: Renz D. Jennings, Chairman
Marcia Weeks, Commissioner
Sharon B. Megdal, Commissioner

APPEARANCES: Jaron B. Norberg, Senior Vice President and Corporate
Counsel, Raymond Heyman, and Snell & Wilmer,
by Steven M. Wheeler, Attorneys for Arizona Public
Service.

Elizabeth Kushibab, Attorney, Legal Division, for
the Arizona Corporation Commission Staff

Steven Avilla, Attorney, for the Residential Utility
Consumer Office

...

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1 BY THE COMMISSION:

2 On April 22, 1986, Arizona Public Service Company ("APS" or "Company")
3 filed an Application with the Commission requesting an Order authorizing the
4 Company, among other things, to enter into various transactions and agreements
5 relating to the sale and operating lease of all or a portion of the Company's
6 undivided ownership interest in the Palo Verde Unit 2 Facilities as hereinafter
7 defined.

8 On April 27, and May 21, 1986, the Coalition for Responsible Energy
9 Education ("CREE") and the Residential Utility Consumer Office ("RUCO") filed
10 Petitions to Intervene herein. Both said Petitions were granted by Procedural
11 Order prior to the scheduled hearing on APS's Application.

12 Pursuant to Notice dated June 26, 1986, APS's Application came on for
13 hearing before a duly authorized Hearing Officer of the Commission at its
14 offices in Phoenix, Arizona, on July 10, 1986. APS, RUCO, and the
15 Commission's Utilities Division Staff ("Staff") appeared through counsel, and
16 each presented testimony and exhibits in support of APS's Application. At the
17 conclusion of a full public hearing, this matter was adjourned pending
18 submission of a Recommended Opinion and Order by the Presiding Officer to the
19 Commission.

20 DISCUSSION

21 As indicated above, both Staff and Intervenor RUCO supported the
22 Application. Staff did propose various reporting requirements which would keep
23 the Commission informed as to the details of the sale and leaseback (as well as
24 any material changes in the transaction both prior to and after closing), and
25 suggested that proceeds derived from such sale and leaseback be placed in a
26 separate interest bearing bank account. Staff and RUCO further recommended
27 that the Commission be circumspect in its language approving this matter so as
28 to retain its flexibility to disallow all or part of the operating lease

1 payments from APS's cost of service in its pending rate proceeding (Docket No.
2 U-1345-85-367). Finally, RUCO noted that recoverability of these lease
3 payments in rates should be subject to performance criteria, and that it would
4 be proposing such criteria in the aforementioned rate Docket.

5 As in Docket No. U-1933-86-036, decided this same day, we will adopt
6 Staff's reporting requirements and will use the same language generally
7 disclaiming any prior judgement on the recoverability through rates of these
8 operating lease payments.¹ We also agree that performance criteria for Palo
9 Verde are appropriate. See Decision No. 55112 in Docket No. U-1345-85-156
10 (Phase I), also decided this day. We will not require that APS separately
11 deposit the funds received through the sale and leaseback transaction.
12 However, periodic reporting on APS's use of such proceeds will serve to
13 reassure the Commission that the limitations on their use both agreed to by APS
14 and ordered hereinafter are being properly observed.

15 * * * * *

16 Having considered the entire record herein and being fully advised in the
17 premises, the Commission finds, concludes and orders that:

18 FINDINGS OF FACT

19 1. APS is an Arizona corporation engaged in providing electric service
20 within various portions of Arizona pursuant to authority granted by this
21 Commission.

22 2. By its Application and testimony in this matter, the Company
23 requests one or more orders granting the following:

- 24 (a) authorization to refinance its construction financing for
25 Unit 2 of the Palo Verde Nuclear Generating Station
26 ("Palo Verde") by entering into one or more sale and leaseback
27 transactions (the "Lease Transactions") relating to (1) all or

28 ¹ Similar language is included in all Commission Decisions authorizing
financing transactions.

1 a portion of the Company's 29.1% undivided ownership interest
2 in Unit 2, including, without limitation, all or a portion
3 of the Company's generation entitlement share in Unit 2 and
4 (ii) certain real property interests in the Palo Verde plant
5 site and related real property (such interest in Unit 2
6 and the real property interests being hereinafter collectively
7 referred to as the "Unit 2 Facilities");

8 (b) authorization for the Company to issue, assume, guarantee, or
9 incur evidences of indebtedness in connection with the Lease
10 Transactions;

11 (c) confirmation that the Leases (as hereinafter defined) will be
12 treated as "operating leases" for accounting and rate-making
13 purposes;

14 (d) confirmation of the rate-making treatment of the Lease
15 Transactions; and,

16 (e) confirmation that the Lessors and the Equity Investors (as
17 hereinafter defined) will not be "public service corporations"
18 subject to regulation under Arizona law by reason of their
19 holding title to, or possessing an interest in, the Unit 2
20 Facilities.

21 3. The Lease Transactions will involve the Company's sale of the Unit 2
22 Facilities to, and then the lease of the Unit 2 Facilities back from,
23 institutional investors ("Equity Investors").

24 4. Each of the Equity Investors will form a trust for the purpose of
25 holding title to its undivided interest in the Unit 2 Facilities, and the
26 trustees under the trusts will act as lessors ("Lessors") of the Unit 2

27 . . .

28 . . .

1 Facilities and will lease the Unit 2 Facilities to APS under one or more leases
2 ("Leases").

3 5. If the Lease Transactions are completed as to less than all of APS's
4 interest in the Unit 2 Facilities, APS will retain an undivided ownership
5 interest in the remainder of the Unit 2 Facilities.

6 6. The Unit 2 Facilities will be sold to the Lessors at a fair market
7 price, and prior to the closing of the Lease Transactions, an appraisal will
8 confirm that the purchase price is a reasonable estimate of fair market value
9 in order to comply with certain Internal Revenue Service requirements to
10 preserve certain tax benefits of the transactions.

11 7. APS's profit on the sale at fair market value of the Unit 2
12 Facilities (net of associated income tax) will be amortized as a credit against
13 APS's operating lease expense over the term of the lease.

14 8. Lessors will borrow approximately 70% to 80% of the purchase price
15 from a funding corporation (the "Funding Corporation") formed for that purpose,
16 and the Funding Corporation, in turn, will borrow the debt portion of the
17 purchase price by issuing debt that will be non-recourse to the Lessors and the
18 Equity Investors.

19 9. The debt referred to in Finding of Fact No. 8, hereinabove, will be
20 indirectly secured by an assignment of the rentals and other payments due from
21 the Company under the Leases.

22 10. APS will be named the "Registrant" in any Registration Statement
23 filed with the Securities and Exchange Commission in connection with the
24 issuance of such debt.

25 11. Upon the occurrence of certain events to be described in the leases,
26 APS will be required to assume the Lessors' debt to the Funding Corporation.

27 12. Throughout the terms of the Leases, APS may direct the Lessors to
28 refund the Lessors' debt to the Funding Corporation at then prevailing interest

1 rates, with net benefits of such refunding to be reflected in the Company's
2 rental payments under the Leases.

3 13. Financial support in the form of letters of credit or financial
4 guarantees will also be obtained to secure the Equity Investors for the payment
5 of amounts by the Company under the leases and related documents, and APS may
6 be required to issue or incur evidences of indebtedness in connection with such
7 financial support.

8 14. Although the Lessors will be the owners of the Unit 2 Facilities,
9 APS will remain responsible for all expenses of operation and maintenance.

10 15. The initial term of the Leases will be approximately 29-1/2 years,
11 and the Company will have certain renewal options.

12 16. APS will have certain options to repurchase the Unit 2 Facilities.

13 17. The rent to be paid by APS over the term of the Leases will be a
14 function of the interest rates payable on the debt issued by the Funding
15 Corporation, the purchase price, marginal tax rates, etc.

16 18. Throughout the term of the Leases, APS will be required with respect
17 to the Unit 2 Facilities to be and to act as a "participant" under the ANPP
18 Participation Agreement, as amended, which governs the construction, operation,
19 and maintenance of Palo Verde and the rights and duties of the joint owners of,
20 and participants in Palo Verde.

21 19. The Company will also continue to serve as "Operating Agent" of Unit
22 2 responsible to the other Palo Verde participants, and as the sole licensee
23 responsible to the Nuclear Regulatory Commission (the "NRC"), for the use and
24 operation of Unit 2, including decommissioning.

25 20. Although APS will remain liable for its share of the decommissioning
26 cost of Unit 2 under NRC regulations, the Lease Transactions may require the
27 Equity Investors to fund a portion of the estimated costs of decommissioning
28 the portion of the Unit 2 Facilities acquired by the Equity Investors.

21. Any addition, betterment, or enlargement of the Unit 2 Facilities, or replacement of units of the property within the Unit 2 Facilities ("Capital Improvements") will be APS's obligation under the Leases.

22. APS may, but will not be obligated to, request that the Lessors provide financing under the Leases ("Supplemental Financings") for their respective shares of Capital Improvements.

23. The terms and conditions of Supplemental Financing will be subject to mutual agreement between the Company and each Equity Investor, and each Equity Investor will have the option, but no obligation, to make additional equity investments in Capital Improvements that are the subject of Supplemental Financings.

24. If any such Capital Improvement is not funded by an Equity Investor, such Equity Investor will, subject to certain conditions, permit the Lessor to borrow additional funds from the Funding Corporation in an amount sufficient to fund such Equity Investor's share of the Capital Improvement.

25. Concurrently with any Supplemental Financings, the rent payments will be adjusted to support the amortization of the additional debt issued in connection with the Supplemental Financing and to preserve the Equity Investors' net economic return.

26. The Company and the Lessors will enter into support agreements that will provide the Lessors with such rights in parts of the company's interest in Palo Verde not constituting Unit 2 Facilities as may be necessary to enable the Lessors and their successors and assigns to realize the residual values of their interests under the Lease Transactions that may be consummated.

27. The proposed Leases will be "operating leases" as defined in accordance with generally accepted accounting principles, and for rate-making purposes the aggregate amount of Lease payments will be accounted for by the Company as an operating and maintenance expense, with the recoverability of

1 such Lease payments through rates to be decided in Docket U-1345-85-367.

2 28. APS intends to use the net proceeds from the Lease Transactions for
3 the redemption, retirement, or refunding of outstanding long-term debt and/or
4 preferred stock that previously financed construction projects and, if
5 necessary, the satisfaction of certain of the Company's working capital and
6 other cash requirements, including the financing of APS's ongoing construction
7 program.

8 29. The payments under the Leases will be chargeable to the Company's
9 operative expenses or to income.

10 30. The issuance, assumption, guarantee, or incurrence of evidences of
11 indebtedness by the Company in connection with the lease Transactions will be
12 for the purpose of allowing the company to perform its obligations and/or
13 exercise its options under the Lease Transactions.

14 31. It has been estimated by Staff and APS that the expected present
15 value savings to ratepayers resulting from the Lease Transactions will range
16 from roughly \$10,000,000 to \$128,000,000.

17 32. The above savings assume the subtraction from APS's rate base of all
18 tax credits generated by the Lease Transactions and retained by APS, subject to
19 ratable restoration over a 35 year period.

20 33. The Lease Transactions and the issuance, assumption, guarantee, or
21 incurrence of evidences of indebtedness in connection therewith are compatible
22 with the public interest, with sound financial practices, and with the proper
23 performance by the Company of service as a public service corporation and will
24 not impart its ability to perform that service.

25 34. The Lease Transactions and the issuance, assumption, guarantee, or
26 incurrence of evidences of indebtedness in connection therewith are reasonably
27 necessary or appropriate for the purposes set forth herein and, except as
28 otherwise set forth herein, are not, wholly or in part, reasonably chargeable

1 to the Company's operative expenses or to income.

2 35. Performance criteria are specifically required in order to assure
3 that ratepayers pay only the allowable costs under efficient operations. The
4 Commission expects the parties to present such performance criteria in the rate
5 case involving the sale and leaseback.

6 CONCLUSIONS OF LAW

7 1. APS is a public service corporation within the meaning of Article XV
8 of the Arizona Constitution and A.R.S. §§ 40-285 and 40-301, et seq.

9 2. The Commission has jurisdiction over APS and of the subject matter
10 of the Application.

11 3. The proposed Lease Transactions and the issuance, assumption,
12 guarantee, or incurrence of evidences of indebtedness in connection therewith,
13 as well as the other matters set forth in the Application, exhibits, and
14 testimony relating to this matter are for lawful purposes within the corporate
15 powers of APS and are compatible with the public interest.

16 4. APS's leasehold interest in the Unit 2 Facilities, including its
17 contractual rights under said Leases, shall be subject to the Commission's
18 authority under A.R.S. § 40-285(A).

19 ORDER

20 IT IS THEREFORE ORDERED that Arizona Public Service Company is hereby
21 authorized:

22 (a) to undertake and consummate the Lease Transactions and to
23 take all such actions as may be necessary or appropriate in
24 connection therewith, subject to the limitations and conditions
25 contained in this Decision;

26 (b) to issue, assume, guarantee, and incur evidences of indebtedness
27 in order to consummate, and to perform its obligations and exercise
28 its options under, the Lease Transactions (including the issuance

1 or incurrence of evidences of indebtedness in connection with the
2 financing of Capital Improvements as required or permitted by the
3 terms of the Leases, the costs of which will be reflected in an
4 adjustment to lease rentals) including, but not limited to, (i) the
5 issuance or incurrence of evidences of indebtedness by the Funding
6 Corporation, secured by the direct obligation of the Company; (ii)
7 the issuance or incurrence of evidences of indebtedness in
8 connection with any letter of credit or financial guarantee securing
9 the Equity Investors for the payment of amounts payable by the
10 Company under the Lease and related documents; (iii) the issuance
11 or incurrence of evidences of indebtedness necessary for any
12 refunding of indebtedness; (iv) the assumption of indebtedness
13 by the Company upon the occurrence of certain events as
14 required by the leases; (v) the adjustment of rents from time
15 to time as required by the Leases; and (vi) the execution of
16 supplements to the Lease as required or permitted by the
17 Leases; and

18 (c) to exercise its options to renew the Leases and to repurchase
19 all or any portion of the Unit 2 Facilities in accordance with
20 the terms of the Leases.

21 IT IS FURTHER ORDERED that the Leases will be treated as operating leases
22 for both accounting and rate-making purposes and that the aggregate amount of
23 Lease payments will be accounted for by the Company as an operating and
24 maintenance expense.

25 IT IS FURTHER ORDERED that all profit from the sale of the Unit 2
26 Facilities (less associated income tax) should be amortized over the initial
27 term of the lease as a credit against such lease expense.

28 IT IS FURTHER ORDERED that Arizona Public Service Company shall treat any

1 tax credits generated by the sale of the Unit 2 Facilities and retained by the
2 Company as an offset (deduction) against its "fair value" rate base, subject to
3 rateable restoration over a 35 year period.

4 IT IS FURTHER ORDERED that approval of the requested Lease Transactions as
5 set forth in the Application and authorized hereinabove does not constitute or
6 imply approval or disapproval by the Commission of any particular expenditure
7 for purposes of establishing just and reasonable rates.

8 IT IS FURTHER ORDERED that Arizona Public Service Company shall file a
9 Plan of Disposition with the Commission within thirty (30) days of the entry of
10 this Decision, which Plan shall indicate the use to be made of the proceeds
11 derived from the transactions authorized herein over the succeeding twelve (12)
12 month period.

13 IT IS FURTHER ORDERED that Arizona Public Service Company shall thereafter
14 annually update such Plan and shall keep the Commission informed of any
15 material change in said Plan.

16 IT IS FURTHER ORDERED that the purposes for which the proposed Lease
17 Transactions are herein authorized are to redeem, retire, or refund outstanding
18 long-term debt and/or preferred stock that previously financed construction
19 projects and, if necessary, to satisfy certain of the Company's working capital
20 and other cash requirements, including the financing of Arizona Public Service
21 Company's ongoing construction program, regardless of the extent to which such
22 purposes may be reasonably chargeable to operative expenses or income.

23 IT IS FURTHER ORDERED that the purpose for which the proposed issuance,
24 assumption, guarantee, or incurrence of evidences of indebtedness in connection
25 with the Lease Transactions is herein authorized is to allow Arizona Public
26 Service Company to perform its obligations and/or exercise its options under
27 the Lease Transactions, which purpose is hereby specifically authorized
28 regardless of the extent to which it may be reasonably chargeable to operative

1 expenses or to income.

2 IT IS FURTHER ORDERED that the terms of the Leases and other documents to
3 be entered into in connection with the Lease Transactions are hereby approved
4 for the specific purpose of enabling each of the Equity Investors and the
5 Lessors to qualify for an exemption by the Securities and Exchange Commission
6 from the Public Utility Holding Company Act of 1935, as amended.

7 IT IS FURTHER ORDERED that Arizona Public Service Company's assumption,
8 guarantee, and incurrence of evidences of indebtedness as herein authorized
9 shall be separate and apart from, and not counted against, Arizona Public
10 Service Company's existing Debt limitation, or against such limitation as it
11 may be hereafter modified by the Commission, that limitation presently being
12 \$2,698,917,000, as approved in the Commission's Order in Decision No. 55017
13 (May 6, 1986).

14 IT IS FURTHER ORDERED that the Commission hereby declares that the Lease
15 Transactions will not cause any of the Equity Investors or the Lessors to be
16 deemed to be a "public service corporation" subject to the jurisdiction,
17 control, or regulation of the Commission under current provisions of Article XV
18 of the Arizona Constitution.

19 IT IS FURTHER ORDERED that Arizona Public Service Company shall file with
20 the Commission any and all documents executed pursuant to the authorizations
21 granted hereinabove (including amendments to such documents executed subsequent
22 to closing) within five (5) business days of their execution, or with regard to
23 those documents executed prior to the effective date of this Decision, within
24 five (5) business days of such date.

25 IT IS FURTHER ORDERED that Arizona Public Service Company shall notify the
26 Commission of any material changes in the terms and conditions of the sale and
27 leaseback transaction authorized hereinabove as soon as is reasonably possible,
28

1 but in any event, at least five (5) business days prior to the closing date.

2 IT IS FURTHER ORDERED that this Decision shall become effective
3 immediately.

4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

5
6 CHAIRMAN

COMMISSIONER

COMMISSIONER

7 IN WITNESS WHEREOF, I, JAMES MATTHEWS,
8 Executive Secretary of the Arizona
9 Corporation Commission, have hereunto set my
10 hand and caused the official seal of this
11 Commission to be affixed at the Capitol, in
12 the City of Phoenix, this 24 day
13 of July, 1986.

14 JAMES MATTHEWS

Executive Secretary

15 DISSENT

16 TLM/djp

BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
Chairman
MARCIA WEEKS
Commissioner
SHARON B. MEGDAL
Commissioner

IN THE MATTER OF THE APPLICATION OF)
ARIZONA PUBLIC SERVICE COMPANY FOR AN)
ORDER OR ORDERS (1) AUTHORIZING IT TO)
ENTER INTO VARIOUS TRANSACTIONS AND)
AGREEMENTS RELATING TO THE SALE AND)
OPERATING LEASE OF ALL OR A PORTION OF)
THE COMPANY'S UNDIVIDED OWNERSHIP)
INTEREST IN UNIT 2 OF THE PALO VERDE)
NUCLEAR GENERATING STATION AND CERTAIN)
COMMON FACILITIES; (2) AUTHORIZING IT)
TO ISSUE OR INCUR EVIDENCES OF)
INDEBTEDNESS IN CONNECTION THEREWITH;)
(3) CONFIRMING THAT THE OWNER TRUSTEE)
AND THE EQUITY INVESTORS WILL NOT BE)
"PUBLIC SERVICE CORPORATIONS";)
(4) CONFIRMING THAT THE LEASES WILL BE)
"OPERATING LEASES" FOR ACCOUNTING)
PURPOSES; AND (5) DESCRIBING THE RATE-)
MAKING TREATMENT OF THE PROPOSED)
TRANSACTIONS.)

DOCKET NO. U-1345-86-105

DECISION NO. 55320

ORDER

Arizona Corporation Commission
DOCKETED

DEC - 5 1986

Open Meeting
December 3, 1986
Phoenix, Arizona

DOCKETED BY	C.M.
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BY THE COMMISSION:

On November 17, 1986, Arizona Public Service Company (the "Company") filed a Motion with the Commission requesting the Commission to issue an order confirming that (i) the Commission's order in Decision No. 55120, dated July 24, 1986, (the "Order") authorizes the Company to enter into Additional Lease Transactions (as hereinafter defined) and (ii) all other aspects of the Order, including, without limitation, the limitation and conditions, authorizations, statutory findings, and conclusions of law set forth therein, are applicable to Additional Lease Transactions.

. . . .

• * * * * • * * * *

1 Having considered the Motion, and being fully advised in the premises, the

2
3 Commission finds, concludes, and orders that:

4 FINDINGS OF FACT

5 1. The Company is an Arizona corporation engaged in providing electric
6 service to the public within portions of Arizona pursuant to authority granted
7 by this Commission.

8 2. On April 22, 1986, the Company filed an Application with the
9 Commission requesting, among other things, authorization to enter into one or
10 more sale and leaseback transactions relating to all or a portion of the
11 Company's 29.1% undivided ownership interest in the Unit 2 Facilities (as
12 hereinafter defined).

13 3. On July 24, 1986, the Commission issued the Order authorizing the
14 Company, among other things, to "undertake and consummate the Lease
15 Transactions and to take all such actions as may be necessary or appropriate in
16 connection therewith, subject to the limitations and conditions contained in
17 this Decision". The Order defines "Lease Transactions" as "one or more sale
18 and leaseback transactions relating to (i) all or a portion of the Company's
19 29.1% undivided ownership interest in Unit 2, including, without limitation,
20 all or a portion of the Company's generation entitlement share in Unit 2 and
21 (ii) certain real property interests in the Palo Verde plant site and related
22 real property (such interest in Unit 2 and the real property interests being
23 hereinafter collectively referred to as the 'Unit 2 Facilities')".

24 4. Pursuant to the authorization contained in the Order, on
25 August 18, 1986, the Company sold and leased back approximately 30.7% of its
26 29.1% undivided ownership interest in the Unit 2 Facilities (the "Initial Lease
27 Transactions"). The total consideration to the Company from the Initial Lease
28 Transactions was \$341,240,000.

1 5. The Company is currently evaluating additional Lease Transactions
2 relating to its remaining undivided ownership interest in the Unit 2 Facilities
3 ("Additional Lease Transactions"), including Additional Lease Transactions that
4 the Company proposes to consummate on or about December 15, 1986. Unlike the
5 Initial Lease Transactions, the proposed December 1986, Lease Transactions may
6 not include a letter of credit issued in favor of the equity investors and may
7 include a portion of the Company's interest in certain common facilities
8 associated with the operation of Unit 2. Another feature of the Initial Lease
9 Transactions, a stepped-up investment tax, will not be available in Additional
10 Lease Transactions.

11 6. By its Motion, the Company requests the Commission to issue an order
12 confirming that (i) the Order authorizes the Company to enter into Additional
13 Lease Transactions and (ii) all other aspects of the Order, including, without
14 limitation, the limitations and conditions, authorizations, statutory findings,
15 and conclusions of law therein, are applicable to Additional Lease
16 Transactions.

17 7. The Company is requesting the Commission to confirm that the Order
18 authorizes Additional Lease Transactions in order to provide potential lenders
19 and investors with the required explicit assurance that Commission approval for
20 the transactions has been obtained. Because the testimony in the
21 July 10, 1986, Commission hearing relating to the Lease Transactions discussed
22 the Initial Lease Transactions that were to take place the following month in
23 more detail than the possibility of Additional Lease Transactions, it is
24 conceivable that the Order may be improperly construed to authorize only the
25 Initial Lease Transactions.

26 8. The Additional Lease Transactions were approved in the Order to the
27 same extent the Initial Lease Transactions were. They are also subject to the
28 same limitations and conditions. Pursuant to the requirements of the

Order, the Company will file with the Commission (i) all documents executed pursuant to the authorizations granted by the Order, including such documents executed in connection with any Additional Lease Transactions, (ii) a plan of disposition indicating the use to be made of the proceeds derived from any Additional Lease Transactions, and (iii) at least five (5) days prior to closing, notification of any material changes in the Lease Transactions authorized by the Order.

9. The recoverability of the Company's lease payments under any Additional Lease Transactions will be decided in Docket No. U-1345-85-367.

ORDER

IT IS THEREFORE ORDERED that this Commission hereby

(i) confirms that the Order authorizes Additional Lease Transactions;

(ii) confirms that all other aspects of the Order, including, without limitation, the limitations and conditions, authorizations, statutory findings, and conclusions of law set forth therein, are applicable to Additional Lease Transactions.

IT IS FURTHER ORDERED that, without limiting the foregoing confirmation, approval of the Additional Lease Transactions does not constitute or imply approval or disapproval by the Commission of any particular expenditure for purposes of establishing just and reasonable rates.

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1 IT IS FURTHER ORDERED that this Decision shall become effective
2 immediately.

3 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

4 
5 CHAIRMAN

6 
7 COMMISSIONER

8 COMMISSIONER

9 IN WITNESS WHEREOF, I, JAMES MATTHEWS,
10 Executive Secretary of the Arizona
11 Corporation Commission, have hereunto set my
12 hand and caused the official seal of this
13 Commission to be affixed at the Capitol, in
14 the City of Phoenix, this 5th day
15 of December, 1986.

16 
17 for JAMES MATTHEWS
18 Executive Secretary

19 DISSENT _____

20 TLM/sks

EXHIBIT F

PROPOSED LANGUAGE FOR ORDER

[Capitalized terms used in the paragraphs below and not otherwise defined are intended to have the meanings given in the Application.]

IT IS THEREFORE ORDERED that the Company is hereby authorized (i) to issue, sell, and incur the Continuing Long-Term Debt and the Continuing Short-Term Debt, as such term is defined below, redeem, refinance, refund, renew, reissue, roll-over, repay, and re-borrow from time to time such Continuing Long-Term Debt and Continuing Short-Term Debt, and establish and amend the terms and provisions of long-term and short-term indebtedness from time to time, (ii) to determine the form of security, if any, for the Continuing Long-Term Debt and the Continuing Short-Term Debt, execute and deliver the Security Instruments, and establish and amend the terms and provisions of the Security Instruments, as may be deemed appropriate by the Company in connection with the Continuing Long-Term Debt and the Continuing Short-Term Debt, and (iii) to pay all related expenses, all as contemplated in the Application and by the exhibits and testimony presented during the hearing in this matter.

IT IS FURTHER ORDERED that the Company is authorized to issue short-term debt at any time and from time to time (excluding current maturities of long-term debt) in an amount not to exceed 7% of the Company's capitalization plus up to an additional \$500 million for purchases of natural gas and power. (All short-term indebtedness outstanding on the date of this Order or hereafter issued or incurred pursuant to this paragraph is referred to as "Continuing Short-Term Debt.")

IT IS FURTHER ORDERED that prior to the issuance or incurrence of the up to \$500 million of short-term debt relating to purchases of natural gas and power, the Company must have a Commission authorized adjustor mechanism for recovery of natural gas or power purchases and, if such mechanism is terminated, the authorization for the additional \$500 million of short-term debt will terminate 12 months thereafter.

IT IS FURTHER ORDERED that if all or a portion of the authorized short-term debt relating to natural gas and power purchases becomes classified as long-term debt because the amount remains outstanding for more than 12 months, such debt will continue to be counted as Continuing Short-Term Debt and need not be counted against the Continuing Long-Term Debt limit.

IT IS FURTHER ORDERED that immediately subsequent to the issuance of any Continuing Long-Term Debt:

(a) The Company must have a minimum common equity ratio of 40% (the “Common Equity Test”). For purposes of this test, the common equity ratio is calculated as common equity divided by the sum of such common equity and the Company’s long-term debt (including current maturities of long-term debt). The Common Equity Test will be calculated as of the end of the most recent calendar quarter prior to the date of calculation, adjusted to give effect to the issuance of any new indebtedness (including the proposed indebtedness for which the calculation is being made).

(b) The Company’s debt service coverage ratio (“DSC”) must be equal to or greater than 1.0. For purposes of this test, the DSC is calculated as operating income plus depreciation and amortization plus income tax, divided by interest on short-term and long-term debt, using the most recent audited financial statements adjusted to reflect the interest impact of changes to

outstanding debt to the date of calculation, calculated as the annualized interest at the actual interest rate on any new debt issued after the 12 month period covered by the applicable audited financial statements and remaining outstanding on the date of calculation and further including for purposes of this calculation, the annualized interest at the expected interest rate on the new long-term debt to be issued or incurred and for which the DSC calculation is being made.

IT IS FURTHER ORDERED that changes in United States generally accepted accounting principles ("GAAP") or changes in the interpretation of GAAP (collectively, "GAAP Changes") shall be treated as follows:

(a) Any contract or other legally-binding arrangement to which the Company is a party as of the date of this Order (the "Existing Obligations") will not be considered indebtedness for purposes of this Order, including the Continuing Long-Term Debt limit, the Continuing Short-Term Debt limit, the Common Equity Test, and the DSC, if the Existing Obligation was not considered indebtedness under GAAP as of the date of this Order, even if a GAAP Change subsequently occurs that results in an Existing Obligation being considered indebtedness. The Company will notify the Commission of any GAAP Change that results in an Existing Obligation being classified as indebtedness within 30 days after the Company files its Quarterly Report on Form 10-Q or its Annual Report on Form 10-K with the Securities and Exchange Commission following the end of the fiscal quarter in which such GAAP Change occurs (the "Notification Period").

(b) If, after the date of this Order, the Company enters into a contract or other legally-binding arrangement that is not considered indebtedness under GAAP but subsequently is considered indebtedness because of a GAAP Change, the Company's obligations under such contract or other legally-binding arrangement will not be considered indebtedness for purposes

of this Order, including the Continuing Long-Term Debt limit, the Continuing Short-Term Debt limit, the Common Equity Test, and the DSC, until further Commission action if, within the Notification Period, the Company files an application with the Commission specifically requesting approval of such reclassified debt obligations.

IT IS FURTHER ORDERED that the authorizations to incur short-term and long-term debt obligations provided in this Order shall replace all existing authorizations for the incurrence of short-term and long-term debt, and all such existing authorizations shall terminate upon the effective date of this Order. Notwithstanding the above, the Commission's Decision No. 55120 (July 24, 1986) and Decision No. 55320 (December 5, 1986) (the "Sale-Leaseback Authorizations") will remain in full force and effect.

IT IS FURTHER ORDERED that the short-term and long-term debt levels authorized in this Order will terminate on December 31, 2012, provided that all short-term and long-term debt outstanding at December 31, 2012 that was previously authorized pursuant to this Order shall remain authorized and valid obligations of the Company. The December 31, 2012 termination date will be extended until the Commission issues a new financing order replacing the then-existing order, provided that (a) the Company files an application for a new financing order on or before December 31, 2011 and (b) the Commission has not issued an order pursuant to such application on or before December 31, 2012.

IT IS FURTHER ORDERED that on each occasion when the Company enters into a new long-term debt agreement, the Company must file with Docket Control a description of the transaction and a demonstration that the rates and terms are consistent with those generally available to comparable entities at the time. No such filing need be made for any such new long-

term debt agreement not involving traditional indebtedness for borrowed money or that has a principal value of less than \$5 million.

IT IS FURTHER ORDERED that the Company is hereby authorized to sign and deliver such documents and to engage in such acts as are reasonably necessary to effectuate the authorizations granted hereinabove.

IT IS FURTHER ORDERED that the purposes for which the proposed issuances of Continuing Long-Term Debt and the Continuing Short-Term Debt are herein authorized are to augment the funds available from all sources to finance the Company's construction, resource acquisition and maintenance programs, to redeem or retire outstanding securities, to repay or refund other outstanding long-term or short-term debt and to meet certain of the Company's working capital and other cash requirements. Such purposes are within those permitted by A.R.S. Section 301 and are permitted regardless of the extent to which they may be reasonably chargeable to operating expenses or to income.

IT IS FURTHER ORDERED that Pinnacle West is hereby authorized under A.C.C. R14-2-803 to guarantee the Company's indebtedness from time to time in indeterminate amounts. The Company is hereby authorized to reimburse Pinnacle West for any amounts paid by Pinnacle West under any guarantee of the Company's debt from time to time, along with interest thereon to the date of reimbursement at a rate of interest not greater than the rate payable on the debt so guaranteed and paid by Pinnacle West.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

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